NAPF Response
DWP Risk Sharing Consultation
August 2008

The case for deregulation

1. Mike O'Brien, Minister of State for Pension Reform has said "this Government wants to help strengthen existing provision to support employers and employees... I want to reduce burdens on current pension schemes, and send a clear message to employers with good DB schemes – we want you to continue… I believe that there are sensible measures we can take to reduce burdens on current pension schemes."

2. The NAPF[1] supports good quality pension provision, whether defined benefit or defined contribution, contract or trust-based. The form of provision should be determined by what is right and most appropriate for the employer and their employees, not by the legislative environment driving employers towards one form of provision and away from another. Yet that is precisely what is happening today - employers are closing DB arrangements as a result of a complex, costly and inflexible defined benefit regulatory environment.

3. Despite scheme closures over the last decade, over 10 million people are building up valuable rights to workplace pensions; the occupational pension income of those recently retired pensioner households was about £10,000 per annum. Occupational pension schemes play a very important part in the lives of many working and retired people, and like the Government we believe it is important this can continue to be the case.

4. As employers start to rethink their pension provision ahead of the 2012 reforms the complexity and costs of the regulatory environment will be a determinant in their decisions to continue – or not – with their existing DB scheme. The current economic climate will inevitably intensify employers' pension considerations. So it is important that the Government delivers on its commitment to role back regulation. This can not be put on the back burner – it requires Government's immediate attention and, more importantly, action. Some employers have already taken drastic action – a CEO of a medium sized fund closed to future accruals this week, stated that "it is too expensive with increased longevity, low investment returns and more importantly government legislation" to keep going.

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1 The NAPF is the leading voice of workplace pensions in the UK. We speak for 1,200 pension schemes with some 15 million members and assets of around £800 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

5. The Government has made a good start. The deregulatory review of private pensions made some helpful recommendations, including reducing the cap on revaluation of deferred pensions from 5% to 2.5% will help ease pressures on schemes. These initiatives have been welcomed by the NAPF.

6. However further work is needed to help sustain today's high quality pension provision. Successive governments have added to today's overblown and unwieldy regulatory environment that has rendered the UK pension system costly, complex and difficult to understand for scheme sponsors, managers and trustees alike. Since 1995 there have been 689 sets of regulations, issued on pensions, excluding tax regulations - a growth in regulations of around one a week. The UK now has one of the most highly regulated pensions sectors

7. For these reasons we support a number of the proposals set out in the consultation document including clarifying the existing rules around risk-sharing and the proposals for enabling conditional indexation. But we also believe wider reforms are needed. We believe the Government should take this opportunity to review the legislation impacting on the running of DB schemes, including the issues covered by the External Reviewers, and bring forward legislation urgently.

8. A recent survey of NAPF members operating private sector DB schemes still open to new members demonstrated the importance of the de-regulatory review to those running pension schemes. The Government has a real opportunity to help rekindle DB pension provision through its deregulatory programme. The key findings from the survey were:

- Overall, when asked what Government could do to encourage employers to maintain DB provision, over half of respondents called for deregulation or for the Government to intervene less in the running of pension schemes.

- While most of the issues and proposals covered by the Government's proposals and the External Deregulation Review are thought likely to sustain DB provision, some commanded more support than others. The two changes that topped the poll related to issues directly affecting the ability of a corporation to operate - the relaxation of the section 75 employer debt regulations and making it easier to return a surplus. Both are important considerations with today's DB pensions decision-makers, Finance Directors.

- A second cluster of proposals which found support amongst today's open DB schemes related to the adoption of a more flexible regime, notably the adoption of principles-based regulation and the introduction of a statutory override to allow specified changes to trust deeds.

- A third group of proposals considered helpful by schemes directly address the original remit of the deregulation initiative, namely rebalancing the costs of providing DB occupational pensions whilst not placing members' security at risk. An example of a regulatory change that funds found helpful was the removal of indexation requirements for future service.

9. In light of the likely impact on scheme behaviour, the NAPF strongly believes that deregulation should continue beyond the risk-sharing review. In particular urgent attention should be given to three reforms described below:

Employer Debt – Section 75

10. The Government has already accepted the External Reviewers recommendation that, where a company that participates in a DB multi-employer scheme ceases to have employees actively participating in that scheme but the scheme continues, the debt should not be triggered if, within a period of up to one year, the employer acquires more employees who participate in the scheme. The NAPF supports this reform. However, we believe further reform is required.

11. NAPF members report that the operation of section 75 and its regulations create unnecessary problems. Of particular concern is the effect of section 75 on legitimate corporate transactions where the requirement for a company involved in a takeover or merger to meet full buy-out costs is acting as a barrier to transactions.

12. We think the existing legislation should be amended. We believe that the circumstances in which the debt is triggered should be narrowed and the amount of debt reduced. Such a change would not place at risk members' benefits but would provide scheme sponsors with much-needed flexibility.

Return of surplus to the employer

13. The current legislation discourages employers from agreeing to target high funding levels as any funding surplus would not be returnable to the employer. It may also deter employers from offering DB provision. Indeed, according to the OECD[2], in countries where a surplus can be returned, DB pensions are more likely to stay open. Examples include Ireland, Netherlands and Portugal.

14. As we said in our response to the External Reviewers, there may be scope to include in scheme recovery plans, the mechanism and circumstances under which a surplus can be returned to an employer. There are two good reasons for adopting this approach. Firstly, this allows for a principles based approach to be adopted. Secondly, schemes will be able to negotiate an arrangement

[2] OECD study in to DB pension schemes, 2007

which suits their needs and meets the requirements of the trustee and sponsoring employer.

Limited Statutory override

15. The NAPF has repeatedly called for the introduction of a limited statutory override that will allow schemes and their sponsors to override provisions in trust deeds and rules that prevent changes to rights permissible in legislation, such as LPI, attributable to future service. We believe the power to utilise such an override should lay with the employer. Whilst the trustee is responsible for ensuring the scheme is operating in accordance with the trust deed and rules, the employer is responsible for meeting the balance of costs and for ensuring that the overall employment package is appropriate to their needs and the needs of their workforce.

16. The ability to make limited changes as prescribed in legislation would allow the employer, who might otherwise be restricted, to amend the benefit structure for future service only. Such a change would not be abused as there is a requirement on employers to consult with scheme members before making specified changes.

17. We urge the Government to include provisions for a statutory override in the current Bill. Legislative reform should be supplemented with guidance for schemes.

Risk sharing within the current regime

18. The NAPF recognises that employers have, and continue to explore, ways in which they can manage the growing cost of DB provision. The NAPF helped members understand options currently available by producing a guide called "All Change" which provided case studies of schemes that have made changes to their design.

19. However, it would be wrong to think that there is enough flexibility within the current framework. The decline in DB membership continues. The table below highlights the decline of DB membership over an 11 year period from 1995 to 2006. Unless changes are introduced the decline can be expected to continue.

Year	Private sector DB (millions)
1995	5.2
2000	4.6
2004	3.6
2005	3.7
2006	3.0

Source: ONS

20. Within the current framework there are a number of measures that Government should take to enable schemes to share risk more effectively.

Normal Pension Age

21. Longevity is a major driver of rising scheme costs. Within DB schemes the risk – and associated costs – of rising longevity are borne by the sponsor. A recent study by Lane Clark and Peacock (LCP) showed that each additional year of life expectancy adds about £11 billion to aggregate FTSE 100 UK liabilities. LCP estimate that about £9 billion extra has been added to deficits between 2006 and 2007, as a result of changes in assumed life expectancy.

22. Perhaps the most logical way of helping pension schemes adjust to increasing longevity is to make it easier for pension schemes to raise Normal Pension Age (NPA). Indeed, this approach has been used by successive Governments in relation to the State Pension Age. Now, not only has it been agreed that women's State Pension Age should be raised from 60 to 65 in line with that od men but, between 2024 and 2056, everyone's State Pension Age will rise from 65 years to 68 years of age.

23. Pensions law already allows scheme sponsors to unilaterally raise NPA for future accruals. However, the bulk of liabilities relate to accrued rights so even where they do so, risks are not fully shared between all members of the scheme and costs are not necessarily reduced enough to guarantee the continuance of the pension. If an employer wishes to change the NPA for past service as well as future accruals, they must get the individual agreement of scheme member affected. Naturally, members who have already changed employers or retired have little direct interest in the scheme remaining open to current and future employees, so it can be difficult to get the necessary consent.

24. The NAPF believes serious consideration should be given to reforming the current rules. Any reform should ensure fair balance is struck between helping scheme sponsors keep the scheme open to new members and ensuring that

scheme members are able to adjust to any changes. Two ways of ensuring member protection are:

- Schemes would only be able to raise NPA for all service in so far as it is needed to match future increases in life expectancy. To ensure that such increases are always based on an objective basis, it may be appropriate to make adjustments in line with an agreed longevity index.
- Only scheme members more than 10 years from retirement would be affected to ensure that they can take account of the new NPA in their retirement plan.

Section 67

25. Another area of concern for scheme sponsors is the impact of Section 67. The Government has said that the courts will decide how statute applies in particular circumstances. However, we believe it would be preferable for section 67 to be clarified via the provision of secondary regulation.

26. Earlier this year the NAPF carried out a qualitative survey of open DB schemes. One of the issues raised was the effect of section 67 on the ability of schemes to raise Normal Pension Age (NPA). Respondents felt that section 67 should not apply to increasing NPA where members had agreed that future accrual would be subject to NPA rising with longevity.

Risk sharing proposals

27. The NAPF strongly supports regulatory flexibility that encourages and enables risk sharing including conditional indexation (CI) and other changes to indexation rules. We support the proposals set out in chapter 6 of the paper for conditional indexation. However, we do not think it should simply be restricted to newly established CARE schemes. Conditional indexation should also be allowed for existing schemes. In our view this will encourage employers offering DB scheme to continue to provide them.

28. Building on the proposals set out in the consultation document we have developed suggestions for how conditional indexation could be applied to existing DB.

Alternative approaches

29. We believe that 21st century pension regulation should have a dual purpose which balances the need to protect member benefits alongside incentives to encourage plan sponsors to maintain occupational pension provision. The best way of encouraging employer commitment is to allow greater flexibility in the design and provision of occupational schemes which should help to sustain good risk-sharing pensions, and guarantee millions of UK employees DB

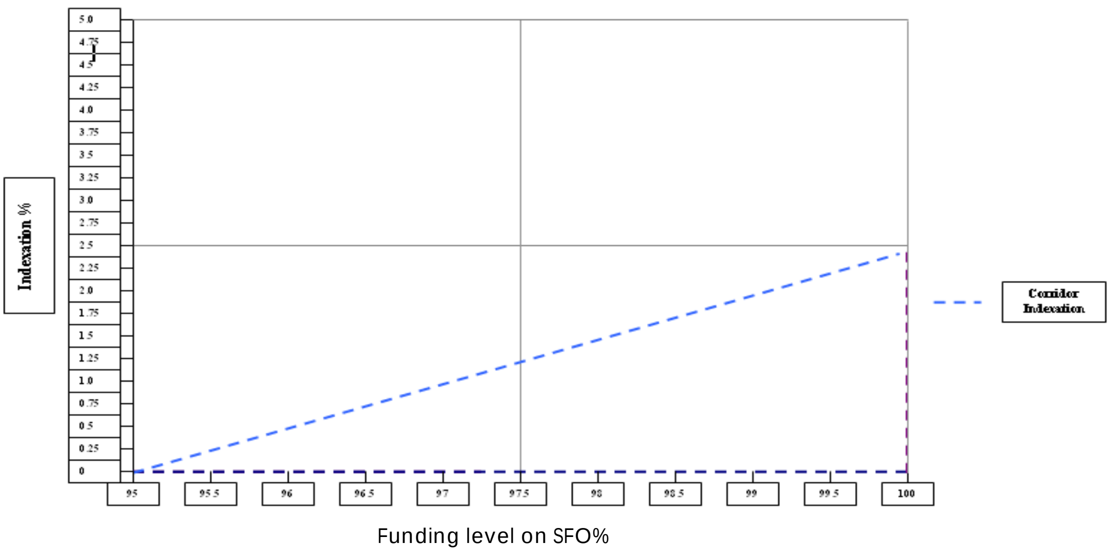
pensions as a result. Under the Pensions Act 2004 the Government removed the mandatory requirement to provide indexation on the contracted out (protected rights) element of a DC member's fund. Similar flexibility should be an option for DB schemes.

30. There are many different ways of sharing the risks of DB provision between employer and employee. The NAPF supports all such measures provided they encourage the maintenance of DB provision, are easy for employers to operate and are fair to scheme members. Nevertheless, to help stimulate fresh thinking in this area we have set out below two new approaches: Corridor Indexation and Optional Indexation. Both involve linking indexation of pension benefits for future service in existing DB schemes.

Corridor Indexation

31. This proposal builds upon and extends the recent proposal from the Association of Consulting Actuaries (ACA) for Conditional Indexation. Under the ACA proposal DB pension schemes would be allowed to reduce or suspend indexation for future accrual of pensions in payment and of deferred pensions subject to certain funding criteria - ie while in recovery on the SFO basis. The degree of indexation would be gradually increased or decreased according to the annual funding level of the scheme.

32. Corridor Indexation would operate as follows: if a scheme is less than 95% funded it would not have to provide indexation but, if it is funded between 95% and 100% of the SFO ("the corridor"), it would provide indexation at a figure somewhere between zero and the current statutory level of 2.5% LPI for both pensions in payment and pensions in deferment. Once funding reaches 100%, full statutory indexation would apply. The level of indexation would be reviewed annually in line with the funding level of the scheme. The level of indexation would increase as the funding level rises and be reduced as it falls. The table below demonstrates how corridor indexation might apply:



33. The intention underlying Corridor Indexation is to allow greater flexibility in funding in order to help stabilise scheme funding of good DB provision. The chief appeal for plan sponsors would be that although scheme funding overall remains unchanged, the timeframe over which it is committed to the scheme would be extended, ie the pace of funding becomes much smoother over time. Schemes could also be encouraged to make up missed years or years of reduced indexation. The decision on whether or not to make up missed years could either be subject to agreement between the scheme sponsor and trustee or simply at the discretion of the employer.

34. Main features of Corridor Indexation are outlined in the table below:

- It would introduce greater flexibility into funding arrangements for scheme sponsors particularly with regard to the pace of funding;
- Whilst members would undergo modest benefit reductions both for pensions in payment and deferred benefits, security of the remaining benefits should be more sustainable as greater flexibility would mean the employer is more likely to keep the scheme open in future;
- The greater flexibility on scheme design could allow any "missed increases" to be potentially made up – either fully or partially - from any future funding surplus either by agreement between the scheme trustees and sponsor (having obtained actuarial advice) or at the discretion of the scheme trustees;
- The additional complexity of this method of indexation may mean some increase in administration costs, particularly from third party providers, to revise pensions increase software programmes and procedures, but these should not be significantly high enough to deter the introduction of Corridor Indexation;
- Similarly although there will be a need for bespoke pensions communications to ensure member understanding, discussions with scheme managers suggest this message should not be any more difficult to communicate than many other technical changes in the period since the Pensions Act 1995 became law.

Optional Indexation

35. Under Optional Indexation the requirement to index pensions in payment would be removed entirely (although it would not become discretionary). Therefore, schemes would simply aim to target the funding level necessary to provide a pension which is not indexed to inflation.

36. This proposal would effectively mirror the current requirements for DC provision and give members the option to choose a flat rate or level pension. However,

under this proposal the scheme would *have* to provide indexation to scheme members as an optional benefit – at the cost of the member. They would also be required to ensure that individuals are provided with clear information and a "health warning" on the consequences of not selecting an indexed pension. The scheme would provide the member with the following options on indexation:

I. on joining the scheme paying extra contributions to receive an indexed pension (capped at 2.5%) on a cost neutral basis;
II. funding indexation at retirement from their lump sum payment (if applicable); or
III. electing to receive a reduced scale pension with future indexation rather than a higher non indexed pension benefit at retirement;
IV. scheme sponsors could even choose to auto enrol the member in to an indexed pension with the member having the choice of opting out.

37. It is important to note that that unlike discretionary benefits, optional indexation would require positive action on behalf of the pension scheme, the trustees and the member to ensure proper communication and design making processes are in place.

38. The main features of Optional Indexation are outlined in the box below:

- It is relatively simple and easy to understand so should give members much greater clarity regarding their benefit options;
- Scheme members who place a high value on receiving indexed benefits would have the personal choice to self fund (via the options set out in paragraph 36 above) or receive a level benefit;
- Member communications could carry a 'health warning' that not opting to provide indexation would mean a reduction in 'real' benefits over time as a result of the impact of inflation;
- DB and DC pension requirements, including Personal Accounts, would become more closely aligned as the mandatory requirement to provide indexation for DB schemes is replaced by member choice;
- As scheme funding is likely to be more predictable with reduced volatility going forward the level of employee pension contributions should become more stable in the future;
- Under Optional Indexation employers and trustees would still have discretion to grant future pension increases on an 'ad hoc' basis.

Other issues – Collective DC, Super Trusts

39. Collective DC offers a new option which employers will welcome providing the legislative requirements are not overly prescriptive. The NAPF believes that employers should be able to run collective DC schemes as outlined in the consultation paper. These schemes include those where the employer pays fixed contributions into the scheme, and the contributions are calculated as a percentage of pensionable pay and are paid into a collective fund instead of individual savings accounts. We support such flexibilities and would be willing to work with the DWP and others to progress plans for collective DC.

40. In addition to supporting collective DC, the NAPF has developed proposals on Super Trusts. These build on some of the principles behind collective DC. Super Trusts would be multi-employer pension arrangements set up on a regional, sectoral or national basis and be authorised by the Pensions Regulator. They would offer a collective investment solution, overseen by trustees. A summary of the Super Trust key features is set out on Page 16.

41. Super Trusts could work alongside collective DC and have many features in common with large occupational schemes which already have low costs and charges. However, they would be new financial institutions, occupying the space between retail pensions and occupational pensions as they exist today. They would be run on a not-for-profit basis, governed by a board of 'trustees' with a legal duty to put members' interests first. Further detail information on Super Trusts is available from the NAPF.

NAPF responses to specific questions raised in the consultation document

Chapter 1: Introduction

1. Given that we have protected scheme members and are bringing in measures to combat undersaving, should we undertake a far reaching deregulation of the way risks are shared in pension schemes?

NAPF response: The Government must take this opportunity to introduce far reaching measures to ensure that going forward the risks inherent in pensions are shared more equally between scheme sponsors and scheme members. We believe this will help sustain private pensions and encourage greater member engagement. The NAPF recently conducted a survey of private sector DB schemes, still open to new members, on deregulation. The key findings from the survey were:

- **Overall, when asked what Government could do to encourage employers to maintain DB provision, over half of respondents called for deregulation or for the Government to intervene less. The Government, therefore, has a real opportunity to help rekindle DB pension provision with the current deregulatory proposals.**

Chapter 2: The decline in defined benefit provision

2. Are you aware of any additional evidence of the actual impact of lower contributions into DC schemes when all these complicating factors are taken into account?

NAPF response: The paper identifies investment choice and contribution levels as the main factors in determining pension outcomes in DC arrangements. It might also be worth considering the impact of different charging structures and governance arrangements. These have not been taken in to account in the paper.

Chapter 3: An overview of risk in pension provision

3. Is our characterisation of the allocation of risks in DB and DC schemes correct?

NAPF response: Whilst the allocation of risks outlined in the paper appear to be correct, the longevity risks in DC also fall on the member and not just the annuity provider - the annuity rate will reflect the life expectancy of the cohort of the individual and may also take in to account circumstances specific to the individual.

4. Which parties are best placed to bear each risk?

NAPF response: There are some risks which the member cannot bear, for example discontinuity risk. However, there are vehicles in place to address these risks including the PPF, FAS, FSCS and FOS. In terms of investment risk, it should be possible to share the risk (upside and downside) of investment between the sponsor and member as well as other risks identified including inflation and longevity risk. There is a further risk which the paper has not identified, that is the sharing of risk between generations, ie the cross subsidy between different age groups. Whilst this risk is different to those identified above, it is a risk that impacts on scheme members' benefits and also the ability of the scheme to adapt to changing circumstances. We believe the DWP should include this as a risk in DB provision.

Chapter 4: Risk Sharing: International Comparisons

5. Are you aware of any further international examples or details of the experiences outlined above, which would be relevant to the debate on risk sharing in this country?

NAPF Response: Whilst there are many international examples that can be drawn upon, we believe that the examples contained in the paper are the most relevant to the UK debate and provide a useful context to risk sharing approaches.

Chapter 5: Risk sharing within the current regulatory framework

6. In general, do you believe greater flexibility in the way employers and employees can share pension risks would increase (or slow any decline in) the availability of high-quality workplace pension provision?

NAPF response: Yes, recent surveys of NAPF members back this up. A number of respondents said that allowing greater risk-sharing and introducing greater flexibility would be welcome. We asked respondents whether they thought allowing schemes to adopt conditional indexation would help sustain DB provisions. All respondents agreed that they thought it would help, not just schemes that are open to new entrants but also scheme that are open to future accruals[3].

7. Would this greater flexibility encourage employers who are considering a move out of DB provision to continue to bear some risk rather than moving fully to DC?

NAPF response: Yes, we believe employers/schemes should have greater flexibility over scheme design and risk sharing arrangements. It would provide employers/schemes with the option to make different choices. See response to question 6.

8. Would employers currently offering DC consider a move to a risk sharing arrangement?

[3] NAPF Deregulation Questionnaire, May 2008

NAPF response: Many employers provide good quality pension schemes for their employees, these schemes might be DB or DC. Some employers might consider offering alternative schemes where the risks are shared more equally than under current DC provision. There are examples where employers have switched from DC provision to a hybrid arrangement, for example Barclays.

9. Do employers consider the existing risk sharing options (for example cash balance schemes, career average) when looking at alterations to DB pension arrangements?

NAPF Response: Many employers do consider all of the options available and decide on the best option depending on their individual circumstances. The current regulatory framework for cash-balance and hybrid schemes makes them very complex and therefore not always seen as good alternatives. In addition, applying DB rules can make employers decide against offering hybrids and cash-balance scheme. Employers also have to consider the impact of the ASB proposals where these will act as a barrier.

10. Have you considered any options other than those outlined in this chapter?

NAPF response: There are examples of schemes that have made various changes to scheme design. Often the changes are only possible for very large schemes and it is important to keep in mind the different challenges faced by schemes of different sizes. The NAPF report "All Change" provides a number of examples of employers which have made changes to their pension schemes. The NAPF has also set out two further ways to achieve risk sharing, Corridor Indexation and Optional Indexation.

11. Have the existing options proved inadequate and if so how?

NAPF response: We do not think existing options are flexible enough, we think further reforms are needed to allow greater risk sharing in existing DB arrangements. We provide further details on what needs to be done in our response to new risk sharing proposals. However, we feel that the regulatory regime is too rigid and a number of changes should be made to give DB schemes more say over the benefits they provide, areas highlighted include the mandatory rules on indexation, the lack of clarify on Section 67 especially as it relates to changing NPA, and the restrictions imposed by Section 75.

12. What could be done to regulation, legislation to make the risk sharing alternatives discussed in this chapter easier to achieve?

NAPF response: As well as changes to existing regulation around indexation requirements, which we cover in our response. It might also be useful to look more closely at the legislation associated with cash-balance and hybrid schemes. It would also be useful for the DWP to clarify the position on Section 67 regarding changes to

NPA and, where necessary, review the impact of Section 67 on schemes abilities to adapt to the changing environment.

13. What could be done in information or guidance to make the risk sharing alternatives discussed in this chapter easier to achieve?

NAPF response: We believe the DWP should issue guidance for schemes clarifying what changes are currently possible, for example, we would urge DWP to issue guidance on changing a schemes NPA for future service. This is something the smaller schemes would welcome and it would also provide greater certainty over possible changes.

14. Is the DB legislative framework disproportionate for cash balance schemes? Should the legislative framework be changed to allow schemes more freedom to apply revaluation and to increase annuity options available to members?

NAPF response: We believe the legislative framework for cash balance schemes should be amended. The current DB framework applied to cash-balance schemes is not appropriate and regulation should be amended to give such schemes greater flexibility recognising the balance between DB and DC provision.

15. Are you aware of any issues related to age discrimination in cash balance schemes in the UK today? Is this an issue which is stopping employers from setting up cash balance schemes?

NAPF response: We are aware of some issues relating to age discrimination legislation and we will be submitting further details.

<u>Chapter 6: Conditional indexation schemes</u>

16. Would the introduction of conditional indexation schemes add significantly to the risk sharing already available to DB schemes?

NAPF response: We believe it would be a very welcome change for existing DB arrangements. We believe the DWP should take forward the necessary legislative changes as soon as possible. See further detail on pages 6, 7, 8 & 9 of the NAPF response.

17. Is sharing investment risk with pension scheme members through indexation and revaluation provisions a suitable response to the costs and risks facing DB scheme sponsors? Is it acceptable that this risk should be transferred to retirees?

NAPF response: We believe it should be possible to share the risk more equitably between all members, including existing, deferred and retired members.

18. Are there other approaches to conditional indexation which you consider to be better?

NAPF response: See detailed response on page 6, 7, 8 & 9 of NAPF response.

19. To what extent would DB scheme sponsors adopt this option as a middle ground for continuing to provide some sort of DB provision? If so, in what circumstances? If not, what might be adopted instead?

NAPF response: The NAPF surveyed members and they would very much welcome greater flexibility, in particular they would welcome deregulation including changes to the current mandatory requirements for the indexation of deferred pensions and pensions in payment. An NAPF survey in 2007 showed that over half of respondents believed there should be proper deregulation and less government intervention.

20. To what extent would DC scheme sponsors be expected to adopt a conditional indexation option to protect their employees from the risks inherent in DC provision?

NAPF response: Scheme members can decide whether they want to purchase an indexed annuity or level annuity, this gives members the flexibility to choose the arrangement which best suits their needs.

21. Are the risks of implementing conditional indexation identified in this chapter appropriate? If not, which other risks do you think apply? How likely is it that these risks would materialise?

NAPF response: There are a number of risks inherent in all different types of pension arrangements. How these risks are managed and communicated to scheme members is very important. The risks identified in the paper are manageable risks.

22. If risk sharing is adopted, what sort of protection for members is appropriate?

NAPF response: The NAPF believe the current regime is able to ensure that members are properly protected and the current risk based approach taken by the Pensions Regulator should continue to operate. We do not believe new forms of protection are required and the current reporting and funding regime can be adopted to ensure that a new system is not abused.

23. Does the fact that the risk sharing available to sponsors depends on the rate of inflation reduce the potential value of conditional indexation to them?

NAPF response: No it does not, it allows for greater smoothing in funding, this will be of benefit to scheme sponsors.

<u>Chapter 7: Collective defined contribution schemes</u>

24. Would the introduction of collective DC schemes add significantly to the risk sharing already available to DB schemes?

NAPF response: We believe it would be a positive addition. The NAPF developed proposals for a different version of collective DC, known as Super Trusts. Super trusts would be multi-employer arrangements which could be set up on a regional, sectoral or national basis and authorised by the Pensions Regulator. The case for Super Trusts is set out on page 10.

Super trust – key features

- Large scale achieved by requiring employers to join a Super Trust (or run a superior alternative) and automatic enrolment for employees, to:
  - ensure scale is achieved quickly;
  - keep costs low and give value for money to workers; and
  - provide enough diversity to achieve good value for consumers without wasteful marketing costs.
- Trust-based – so members' needs are put first.
- Collective investment, to give:
  - the potential for higher returns; and
  - investment decisions to expert trustees, rather than inexpert individual savers.
  - Individual Super Trust Accounts for each member to provide a "lifetime pot" for consumers.

25. Is sharing investment risk between pension scheme members through indexation and revaluation provisions a suitable response to the costs and risks facing DB scheme sponsors?

NAPF response: Yes, we believe it is a suitable and appropriate response.

26. To what extent would DB scheme sponsors adopt this option as a middle ground for continuing to provide some sort of DB provision? If so, in what circumstances? If not, what might be adopted instead?

NAPF response: There has been support for allowing greater flexibility in scheme design, legislation must not become overly complex so that employers are not attracted to alternative arrangements.

27. To what extent would DC scheme sponsors be expected to adopt a collective DC option to protect their employees from the risks inherent in DC provision?

NAPF response: It will be for individual employers to decide what pension arrangement best suits their needs and the needs of their employees.

28. Do you think members would accept this way of sharing risk?

NAPF response: Some employees may welcome collective DC as an alternative design to pure DC. It allows for collective investment which may be appealing to scheme members.

29. Are the principles for the regulation of collective DC schemes appropriate? If not, which other principles would be appropriate? Would these schemes be able to operate under these principles?

NAPF response: They appear to be appropriate.

30. Is the attraction of collective DC great enough to justify the creation of new regulatory regime for them? Are the other ways in which they would be permitted?

NAPF response: Whilst we believe collective DC might be attractive to some very large employers it does not address the current problems of regulation facing existing DB provision. In general we would encourage greater flexibility for scheme design, a principles based approach should be appropriate.

31. What else could be done to increase the certainty or predictability for members in DC schemes?

NAPF response: Member understanding is a key issue which needs to be addressed. For example many schemes offer matching contributions, scheme members need to understand the implications of not drawing on additional contributions available from their employer. There is also evidence to show that a high proportion of scheme members use the default option without understanding the implications.

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